

THE ECONOMIC IMPACT OF DIFFERENTIAL INTERNATIONAL TRADE CONTROLS
ON COMMUNIST CHINA: A SUMMARY OF INTELLIGENCE CONCLUSIONS

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on Communist China: A Summary of Intelligence Conclusions

Summary

The differential list applied to China does not deny controlled goods of Western origin to Communist China, because such commodities not denied the Soviet Bloc can be transshipped to China. It does, however, result in increased costs in obtaining these goods. Since the control system prohibits the use of Western shipping for the transport of such goods even when of Bloc origin, and because Bloc shipping is limited, a large volume of such goods must move overland at significantly increased transport costs. The cost of international differential controls to Communist China (including both foreign exchange and internal costs) during 1955 is estimated at \$37-43 million, as indicated in Table 1 below.*

Table 1

Estimated Cost to Communist China of Differential International
Trade Controls During 1955

(millions of \$ U.S.)

Increased Transport Costs	\$29-35
Premium Payments	8-8
	<u>\$37-43</u>

Moreover, the Soviet Bloc incurs an additional \$53-76 million of increased freight costs resulting from the differential control system.**

It is estimated that, in the long run, neither the annual nor the cumulative cost of differential controls will significantly retard the development of the Chinese economy.

* This estimate does not include potential foreign exchange earning which might accrue to Communist China from increased exports to Japan, following the removal of differential controls (see p. 4 below); nor does it include foreign exchange losses resulting from U.S. unilateral controls.

** See Annex A.

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1. Denial Effect of Differential Multilateral Trade Controls*

Notwithstanding the large differential between the list of goods embargoed for export to Communist China and that embargoed to the Soviet Bloc, goods not denied to the Soviet Bloc cannot effectively be denied to Communist China. Such goods can be and are being sent to China via the Soviet Bloc. For example, over 100,000 tons of controlled goods of Western origin in 1954 was shipped to China through European Bloc ports. This included over one-quarter of China's imports of iron and steel during 1954. In spite of the embargo these products reached China via Polish ports.

2. Economic Costs of Differential Multilateral Controls

Even though the differential embargo does not effectively deny listed goods to China, it does result in increased costs and delays in the procurement of such goods. The most important increased costs involve transport costs and premium prices paid in order to obtain embargoed items.

A. Increased Transport Costs

Present controls prohibit the use of Western shipping for the delivery to Communist China of items on the differential list, whether obtained from the Free World or the rest of the Bloc. Thus, such goods must be sent overland** or transshipped. The most significant effect on Communist China stems from the resulting higher freight costs.

* It should be noted that the CHINCOM differential controls also apply to trade with North Korea and North Vietnam. The costs to North Korea and North Vietnam are, however, not estimated in this paper.

** By far the largest single item shipped overland is POL. If all controls against the use of tankers were dropped, a saving to the Bloc of about \$90 million in POL transport costs, based on 1955 estimates, would result. However, discussion in this paper is limited to those savings which would result from the removal, not of all controls, but only of differential controls. In this category, relief to POL movements would be restricted to crude oil, which is now embargoed to Communist China but not to the Soviet Bloc, and consequently cannot be carried to China on Western ships even if obtained from within the Bloc. The estimated savings to the Bloc which would result from the removal of the embargo on shipping crude oil have been included in Table 2 below.

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In the absence of controls, Communist Chinese trade in the commodities concerned could move by more expeditious routes at more advantageous rates. It is estimated that during 1955, as a result of the differential controls, transport costs (on both imports and exports) will be greater by \$29-35 million than they otherwise would be. Of these increased costs, approximately \$10 million represents external expenditures and the remainder, internal costs.* Overland routings induced by the differential controls, which account for most of the additional freight costs, involve primarily shipments originating west of the Urals. Most shipments originating east of the Urals are generally moved overland in any case.

Of the \$29-35 million increased transport costs incurred by Communist China, all but \$2 million is the result of the use of expensive overland transport facilities rather than ocean shipping which is prevented by the ban on the use of Western ships for carrying goods under differential controls. The remaining \$2 million results from increased handling costs for goods on the differential control list which were shipped from Western sources to European Bloc ports and unloaded and reloaded on to Bloc-flag or chartered vessels destined for China.

The costs indicated above relate to increased transport costs incurred by Communist China. Actually, the effect of the differential control system is to impose greater transport costs on the Soviet Bloc than on Communist China. It is estimated that during 1955 the Soviet Bloc will incur additional overland freight charges amounting to \$53-76 million.

In summary, the increased transport cost incurred by the entire Bloc, as a result of the differential multilateral controls, are as indicated in Table 2 below.

Table 2

Increased Transport Costs to Sino-Soviet Bloc as Result
of Differential Controls During 1955

(millions of \$ U.S.)

Communist China	\$29 - 35
USSR	48 - 67
Satellites	5 - 9
	<u>\$82 - 111</u>

* Although both external expenditures and internal costs are expressed in dollar equivalents, it should be noted that only the external expenditures involve a foreign exchange drain.

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B. Premium Payments

In order to obtain commodities on the differential list from suppliers outside the Soviet Bloc, the Communist Chinese must sometimes pay premium prices. The increased costs involved during 1955 are estimated at \$8 million.*

C. Delays in Obtaining Communist Chinese Imports and Loss of Export Earnings

In addition to the costs indicated above, differential controls create delays and difficulties to the Communist Chinese in their obtaining of imports. In the case of high-priority goods these delays and difficulties have unquestionably had some negative impact on Chinese production. The effects of this impact cannot be estimated, but they are thought to be minor.

Furthermore, Communist Chinese export earnings may be reduced as a result of the operation of CHINCOM controls.** The main trading partner where this would be of some quantitative importance is Japan. It is estimated that during 1955 Chinese exports to Japan could have been from \$25-35 million greater without a significant diversion of resources from other commitments if Japan had been permitted to export to China goods presently embargoed. This limitation on Communist Chinese exports to Japan, however, apparently results primarily from a Chinese political decision to limit exports to Japan because of Japanese adherence to the CHINCOM control system, and is not a necessary consequence of that system. Therefore, this reduction of Communist Chinese export earnings is not a direct cost imposed on China by the differential control system, although it is in a sense an effect of that system. Because it is not a direct cost, it is not included in the total of costs summarized in Table 1 above.

3. Long Run Economic Impact of Trade Controls

The Communist Chinese economy, over a period of time, can make adjustments which will negate much of the effect of differential trade controls. The delays involved in present procurement can be reduced through the use of alternative Bloc sources, improved procurement scheduling, and more

* This is considerably less than the estimate for 1954 of \$20-25 million. This is the result in part of a smaller volume of smuggling, but to a larger extent of the discontinuance during the first half of 1955 of premium prices paid to Ceylon for rubber.

** The United States unilaterally prohibits the import of all goods from Communist China. The loss of Chinese export earnings resulting from United States import controls is estimated at approximately \$60 million in 1955. Also, the U.S. limitation on the transfer of remittances will result in a further loss of foreign exchange estimated at \$40 million during 1955. No country other than the United States maintains such controls.

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effective shipping and handling methods. Even though the Communist Chinese may continue to obtain embargoed goods of Western origin indirectly through Bloc intermediaries, in the long run the additional costs involved will undoubtedly decline. As more Bloc shipping (flag and charter) becomes available, the delays, additional demurrage charges, etc. will diminish. More importantly, uneconomical rail hauls involving shipments originating west of the Urals will become unnecessary.

It is estimated that, in the long run, the adjustments indicated plus the development of new Far Eastern markets will minimize the impact of differential controls, and that the cumulative costs will not constitute an appreciable deterrent to Communist Chinese industrialization plans.

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ANNEX A

ESTIMATED COSTS OF INTERNATIONAL DIFFERENTIAL
CONTROLS ON COMMUNIST CHINA
1955
1956

(millions of \$ U.S.)

To China

Increased Transport Costs

On imports

24 - 28

On exports

5 - 7

29 - 35

Premium Payments

8

Total China

37 - 43

To USSR

Increased Transport Costs

48 - 67

To European Satellites

Increased Transport Costs

5 - 9

TOTAL

90 - 119

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